

Message Text

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ACTION ARA-10

INFO OCT-01 ADP-00 FBO-01 RSC-01 RSR-01 INR-10 /024 W

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R 052056 Z JUL 73

FM AMEMBASSY BUENOS AIRES

TO SECSTATE WASHDC 2697

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E. O. 11652: N / A

TAGS: ECON, AR

SUBJECT: EFFECT OF INFLATION ON CONSTRUCTION OF NEW CHANCERY

REF STATE 128239

1. APU WILL APPRECIATE BETTER THAN MOST THE DIFFICULTIES IN RESPONDING WITH ANY PRECISENESS TO REQUEST FOR PREDICTION ON RATE OF INFLATION AND DEVALUATION POSED BY FBO. BEYOND NORMAL DIFFICULTIES INHERENT IN ANY PREDICTION COVERING TWO YEAR PERIOD, IN THIS CASE WE FACE SITUATION WHERE COMPLETELY NEW GOVERNMENT IS INITIATING MAJOR CHANGES OF ECONOMIC POLICY INTENDED TO MODIFY STRUCTURE OF ARGENTINE ECONOMY AND, THEREFORE, TO CHANGE MANY BASIC

PARAMETERS WITHIN WHICH PREDICTIONS MUST BE MADE. FOR THESE REASONS WE DOUBT THAT WE HAVE ABILITY TO MAKE ANY BUT MOST GROSS GUESSTIMATES CONCERNING MAGNITUDES OF PROBABLE CHANGES OVER TWO YEARS.

2. WITH GREATEST OF RESERVATIONS WE FEEL THAT RATE OF INFLATION OVER COMING YEAR (I. E. TO MID-1974) LIKELY TO BE IN ORDER OF 30 PERCENT. THIS ALLOWS FOR CONSIDERABLE SUCCESS IN INITIAL PERIOD OF GOA PRICE CONTROL PROGRAM RECENTLY PLACED IN EFFECT, TOGETHER WITH SOMEWHAT LESS SUCCESS IN LATTER PART OF FY74. WE BELIEVE THE CHANCES OF MAINTAINING WHAT FOR ARGENTINA IS RELATIVELY

AUSTERE PROGRAM DURING TWO YEARS HAS ONLY MODERATE CHANCE FOR SUCCESS, THEREFORE WE EXPECT RATE OF INFLATION IN FY75 TO BE SOMEWHAT GREATER THAN IN FY74, PERHAPS 40-50 PERCENT. THEREFORE, OUR PREDICTION IS FOR WHOLESALE PRICES AND CONSTRUCTION COSTS TO BE LIMITED OFFICIAL USE

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80-100 PERCENT OVER TODAY'S LEVELS BY MID-1975. TO PUT OUR PREDICTION IN ANOTHER FORM, PERHAPS MORE USEFUL FOR FBO, WE ANTICIPATE INCREASES TO AVERAGE 2.5-3 PER CENT PER MONTH DURING FY74 AND ABOUT 3.5 PERCENT PER MONTH IN FY75.

3. CONCERNING DEVALUATION, WE ARE QUITE CONVINCED THAT NEW GOA WILL MOVE IN ABOUT SEPT- OCT 1973 TO ADJUST EXCHANGE RATES. WE ANTICIPATE GOA WILL ESTABLISH MULTIPLE EXCHANGE RATES TO BE USED TO CONTROL AND GUIDE IMPORTS, TO FACILITATE EXPORTS, ETC. IN SUCH A SYSTEM, WE WOULD EXPECT THAT THERE WOULD BE A FINANCIAL RATE, AS THERE IS NOW, WHICH THE EMBASSY- USG WILL PROBABLY HAVE TO USE IN ARRANGING PESO PAYMENTS. WE BELIEVE THE DEVALUATION WILL NOT BE GREAT AND WOULD ANTICIPATE THAT THE FINANCIAL RATE MIGHT BE MOVED BETWEEN 10 AND 15 PERCENT, TO 11.00-11.50 PER DOLLAR. WE BELIEVE THE LIKELIHOOD FOR A MOVE SUCH AS IS DESCRIBED IS HIGH BECAUSE, ALTHOUGH THE CENTRAL BANK NOW HAS ABUNDANT GROSS RESERVES, THE GOA'S FLEXIBILITY IN PROMOTING EXPORTS THROUGH SUBSIDIES FROM THE BUDGET IS SEVERELY CONSTRAINED. TO MAINTAIN THE EXPORT DEVELOPMENT PROGRAM, AND WE BELIEVE THE NEW GOVERNMENT RETAINS A DETERMINATION TO DO SO, THE GOA IS MOST LIKELY TO MOVE TOWARD EXCHANGE RATE ADJUSTMENT. WE ARE NOT SO CERTAIN CONCERNING THE TIMING OF THE MOVE BUT BELIEVE THAT RISING PRESSURES FROM EXPORTERS AND THE GOA'S SENSE OF SECURITY AND ABILITY TO UNDERTAKE EXCHANGE RATE ADJUSTMENTS INDICATE SEP 1973 AS THE EARLIEST PROBABLE PERIOD FOR SUCH A MOVE.

4. EXCHANGE RATE DEVELOPMENTS IN 1974 AND EARLY 1975 ARE THE MOST DIFFICULT OF THE PREDICTIONS REQUESTED. THE VOLUMES OF GRAINS AND MEAT WHICH WILL BE AVAILABLE FOR EXPORT IN 1974/75 AND WORLD MARKET CONDITIONS FOR SUCH PRODUCTS WILL DETERMINE THE DEGREE OF EASE OR DIFFICULTY FOR THE ARGENTINE BALANCE OF PAYMENTS. THESE DEPEND ON FACTORS WHICH ARE MOST DIFFICULT TO PERCEIVE CLEARLY AT THIS TIME. IF FBO WISHED TO MAKE A VERY CONSERVATIVE ESTIMATE (ON THE HIGH SIDE) OF PROBABLE BUILDING COSTS, IT SHOULD NOT COUNT ON ANY FURTHER DEVALUATION BEYOND THE INITIAL ONE PREDICTED IN THE PRECEDING PARAGRAPH. A CALCULATION ALLOWING FOR POSSIBLE FURTHER 10 PERCENT DEVALUATION IN SECOND SEMESTER FY74 MIGHT BE ALLOWABLE BUT ANY PREDICTION CONTAINING ASSUMPTION OF GREATER DEVALUATION BEFORE MID-1975 WOULD RUN RISK OF BUDGETING TOO LITTLE FUNDS FOR PROJECT.
DECON 7/3/75.

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*** Current Handling Restrictions *** n/a

*** Current Classification *** LIMITED OFFICIAL USE

Message Attributes

Automatic Decaptioning: X
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: n/a
Control Number: n/a
Copy: SINGLE
Draft Date: 05 JUL 1973
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: golinofr
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1973BUENOS04777
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: n/a
Errors: n/a
Film Number: n/a
From: BUENOS AIRES
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1973/newtext/t19730766/aaaajzct.tel
Line Count: 117
Locator: TEXT ON-LINE
Office: ACTION ARA
Original Classification: LIMITED OFFICIAL USE
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 3
Previous Channel Indicators:
Previous Classification: LIMITED OFFICIAL USE
Previous Handling Restrictions: n/a
Reference: 73 STATE 128239
Review Action: RELEASED, APPROVED
Review Authority: golinofr
Review Comment: n/a
Review Content Flags:
Review Date: 15 JAN 2002
Review Event:
Review Exemptions: n/a
Review History: RELEASED <15-Jan-2002 by martinjw>; APPROVED <06-Feb-2002 by golinofr>
Review Markings:

Declassified/Released
US Department of State
EO Systematic Review
30 JUN 2005

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: <DBA CORRECTED> srp 980312
Subject: EFFECT OF INFLATION ON CONSTRUCTION OF NEW CHANCERY
TAGS: ABLD, ECON, AR
To: STATE
Type: TE
Markings: Declassified/Released US Department of State EO Systematic Review 30 JUN 2005